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CASE COMMENT

ConocoPhillips v Venezuela[1] and Gold Reserve v Venezuela[2]

Expropriation: A New Focus on Old Issues

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Rules on expropriation have long formed the core of the field of international investment law, but have not been in the centre of arbitral practice and scholarly debate in the past decade. Several developments may explain this loss of prominence. First, cases of outright expropriations have become rare after the 1990s, in a climate with an international focus on the beneficial effects of foreign investment. High-profile nationalizations in Latin America are an exception to this overall trend. Second, counsel and tribunals have tended to focus less on rules of expropriation and more on the scope of rules on fair and equitable treatment (FET) in cases of host State interference with foreign investment below the threshold of a formal taking. Third, the emphasis in arbitral practice on continued control on the part of the investor as a dividing line between compensable takings and non-compensable regulatory measures has contributed to reduce the practical significance of rules on indirect expropriation. When faced with the option to decide a case under rules on FET or norms on indirect expropriation, tribunals have been more inclined to turn to the former, albeit for reasons that are not always clearly articulated.

Possibly, this trend away from the application or rules on expropriation may come to a halt in the future. More recently, the scope of protection afforded by the rules on fair and equitable treatment has no longer been considered as self-evident and has been criticized, rightly or wrongly. One may only compare the classical clauses on FET in treaties concluded by European States with the FET clause in the Canada–EU Draft Comprehensive Economic and Trade Agreement to recognize the retrogressive evolution of the FET standard. A resurgence of the rules on expropriation may follow in the wake of the new calibration of the FET standard. Just as an expansion of FET has been accompanied by a relative retreat of rules on expropriation, the trend to narrow the scope of FET may give rise to a renewed emphasis on rules governing expropriation.

[1] *ConocoPhillips Petrozuata BV, ConocoPhillips Hamaca BV and ConocoPhillips Gulf of Paria BV v Bolivarian Republic of Venezuela*, ICSID Case No ARB/07/30, Decision on Jurisdiction and Merits (3 September 2013).

[2] *Gold Reserve Inc v Bolivarian Republic of Venezuela*, ICSID Case No ARB(AF)/09/1, Award (22 September 2014).

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Against this background, it will be useful to pay particular attention to recent case law on expropriation and possible trends in this jurisprudence. This Case Comment will focus on two cases with Venezuela as respondent: the *ConocoPhillips v Venezuela* case decided in September 2013 and the Award in *Gold Reserve v Venezuela* of September 2014. Both cases confirm the traditional parameters in principle, but they also point to open issues in their understanding.

The *ConocoPhillips v Venezuela* case arose out of Venezuela's treatment of the Claimants during the wave of nationalizations in Venezuela's energy sector in the past decade. In the 1990s, Conoco had acquired the long-term right to explore and exploit oil in three areas, onshore and offshore. While Venezuela's Constitution of 1999 underlined its sovereignty over petroleum activities,[4] the Government conducted a successful policy of *apertura* between 1990 and 2001 to attract to Venezuela foreign investors that had sufficient finances and necessary technology for the benefit of the local economy and finances.

After 2001, President Chavez turned back the dial when oil prices were rising, and propagated policies of resource nationalism. As to the existing oil concessions held by foreign companies, the Chavez Government sought to implement the new policies of sovereignty by way of introducing mixed companies in which the domestic Venezuelan partner would hold the majority interests and the foreign partner the remaining minority part. Thus, the foreign companies were to abandon their vested rights in their concessions and instead 'migrate' into a reduced minority status in the mixed companies. A transition period allowing for a negotiated approach to achieve this migration was to run for four months; failing an agreement in this short period, the rights of the foreign investor were to be expropriated.

Contrary to the course of most other investors, ConocoPhillips (along with ExxonMobil) decided to oppose this scheme of abandonment of its rights. In turn, Venezuela considered that Conoco lacked a cooperative spirit, and went straight ahead to implement its policy, with the seizure of Claimants' assets followed by a termination of the concessions. A key point in Venezuela's further approach was not to offer a specific amount of compensation, but to seek to negotiate a compensation deal. Also, Venezuela insisted that Conoco would waive all its rights when an agreement was reached. These negotiations failed, with both sides accusing each other of unrealistic, unacceptable positions. Conoco considered at one point that Venezuela's offer amounted to 5% of the real value of the investment based on book value.[5]

The BIT between the Netherlands and Venezuela was applicable as the three Claimant companies had incorporated in the Netherlands before the dispute had arisen. The Claimants considered the following Venezuelan measures to be in breach of the BIT:

- the gradual increase of the effective royalty rate from 1 percent to 33 percent;
- the tax increase from 34 percent to 50 percent;
- the takeover of the investment projects;

[4] Constitution of Venezuela of 1999 (1999) art 302.
[5] *ConocoPhillips* (n 1) para 390.

- the cancellation of the contractual rights, accompanied by the offer of a minority interest in new mixed enterprises, without a provision for adequate compensation.

Two of the investment agreements concluded by Claimants contained clauses limiting the liability of Venezuela in the context of implementing these agreements.

As to the BIT, Article 3 contained a clause on fair and equitable treatment. However, Article 4 provided a carve-out for taxes and other fiscal measures.[6] In the view of the Tribunal, the measures covered by the carve-out were not subject to the provisions on FET laid down in Article 3; moreover, the Tribunal considered that royalties as well were to be considered as taxes within the meaning of Article 4.

The broader legal framework of the investment was characterized by a perplexing diversity. On the domestic side, the Constitution called for sovereignty, whereas the Investment Law recognized the need for stability. In 2006 and 2007, President Chavez announced policies of a progressive recovery of oil sovereignty, and a speech by a Minister in 2008 stated that 'a policy for the recovery of Absolute Oil Sovereignty' had been initiated by President Chavez as early as 1999, while the BIT with the Netherlands provided for procedural and substantive guarantees for the foreign investor. Issues of expropriation were covered in traditional manner in Article 6.[7]

The investment contracts included clauses designed to promote stability, but these did not go as far as stabilization clauses; the concessions also contained clauses meant to deny liability in case of measures changing the rules applicable to investors. For instance, Condition 19 of the Venezuelan Congressional Authorisation for New Areas (1995) stated that an agreement:

> . . . shall in no case give right to liability or [sic] any nature or type to the Republic of Venezuela, nor be detrimental to its sovereign rights, and the exercise of such Agreement shall in no case give rise to claims by other Governments or foreign powers.

Given that the Article on FET (Article 3) did not apply to tax measures, the main focus of the Award was on the application of the rules on expropriation. A first

[6] Constitution of Venezuela (n 4) art 4 reads as follows:

> With respect to taxes, fees, charges, and to fiscal deductions and exemptions, each Contracting Party shall accord to nationals of the other Contracting Party with respect to their investments in its territory treatment not less favourable than that accorded to its own nationals or to those of any third State, whichever is more favourable to the nationals concerned. For this purpose, however, there shall not be taken into account any special fiscal advantages accorded by that Party:
> (a) under an agreement for the avoidance of double taxation; or
> (b) by virtue of its participation in a customs union, economic union, or similar institutions; or
> (c) on the basis of reciprocity with a third State.

[7] ibid art 6:

> Neither Contracting Party shall take any measures to expropriate or nationalise investments of nationals of the other Contracting Party or take measures having an effect equivalent to nationalisation or expropriation with regard to such investments, unless the following conditions are complied with:
> (a) the measures are taken in the public interest and under due process of law;
> (b) the measures are not discriminatory or contrary to any undertaking which the Contracting Party taking such measures may have given;
> (c) the measures are taken against just compensation. Such compensation shall represent the market value of the investments affected immediately before the measures were taken or the impending measures became public knowledge, whichever is the earlier; it shall include interest at a normal commercial rate until the date of payment and shall, in order to be effective for the claimants, be paid and made transferable, without undue delay, to the country designated by the claimants concerned and in the currency of the country of which the claimants are nationals or in any freely convertible currency accepted by the claimants.

issue to be addressed by the Tribunal concerned the date of valuation.[8] It is settled that, as a rule, customary international law requires that the date of the Award will be relevant in case of a breach of international law, whereas for a lawful expropriation, the valuation will be set at the date of the taking. Under Article 9 of the BIT, an award was to be based, *inter alia*, on the general principles of international law.

In the *Conoco* case, Venezuela questioned these basic principles and sought to focus on the date of the taking as an unlawful action. Not surprisingly, the Tribunal properly pointed to the *Chorzów*[9] case and applied the classical rule of customary international law.

A second line of argument by the parties pertaining to Article 6 of the BIT was whether the expropriation was 'in breach of an undertaking' within the meaning of said article.[10] A key issue here was whether conduct creating legitimate expectations (as known in the context of fair and equitable treatment) would be considered as an 'undertaking'. The Tribunal opted for a more narrow construction that required a binding statement.

> The Tribunal understands the word 'undertaking' to bear its ordinary meaning of a promise. In the context of a binding international agreement, the promise is one which is binding in law on the person who has made it.[11]

A third point concerned the issue of a creeping expropriation in several steps between 2004 and 2007 which would have opened up the possibility of a valuation date at the beginning of the measures.[12] However, the Tribunal had no difficulty in rejecting this argument. The early tax and royalty measures in 2004 and 2005 fell under the tax exemption in Article 4 and therefore could not justify any reasoning that adjudged these measures as part of an unlawful action.

Finally, the most problematic issue in the Decision pertained to the determination of the compensation due to Claimants after the expropriation of their investments.[13] The starting point here was that Venezuela did not offer an amount commensurate to the real values concerned, and for one project it made no offer at all.[14] It is generally recognized that book value is not an appropriate valuation method for an on-going successful enterprise. Venezuela pointed to the clauses limiting its liability in the investment agreements, which, however, could not override the applicability of rules of international law under Article 9 of the BIT.

What Venezuela offered was book value coupled with a course of negotiations on the proper amount.[15] No agreement was reached after several rounds of discussions, and Venezuela did not even respond to some communications that were sent by Claimants. The record does not seem to indicate that Venezuela ever offered an amount close to the market value.

The Tribunal considered that the legality of Venezuela's conduct was determined by the presence or absence of good faith in the negotiations on the

[8] *ConocoPhillips* (n 1) paras 337–43.
[9] *The Factory at Chorzów (Germany v Poland)* (Jurisdiction) [1927] ICJ Rep Series A No 9.
[10] *ConocoPhillips* (n 1) paras 344–51.
[11] ibid para 348.
[12] ibid paras 352–60.
[13] ibid paras 361–402.
[14] ibid para 391.
[15] ibid para 399.

payment. The BIT stated that payment was to be made 'without delay'. On this, the Award states without citing any authority:

> . . . it is commonly accepted that the Parties must engage in good faith negotiations to fix the compensation in terms of the standard set, in this case, in the BIT, if a payment satisfactory to investor is not proposed at the outset.[16]

The better view would require the host State to make adequate payment on its own, without undue delay. It is not for the expropriated investor to seek compensation by way of a negotiated deal. Under international law, the host State has to provide for adequate payment once it has acquired the investment. If it fails to do so, it will act in violation of the BIT, and the investor may bring a claim in the appropriate forum. The burden to provide proper compensation naturally lies with the expropriating host State, not with the expropriated investor. Should difficulties in calculation arise, the host State may request information from the investor when appropriate, thereafter promptly decide on the amount, and make payment. Acting in its own public interest when expropriating, the host State does not have the discretion to shift the burden of determining the amount of compensation to the investor. The duty to decide and to pay is a unilateral one, for the host State.

Gold Reserve v Venezuela,[17] addressed rights held by the Claimant since the 1990s under two gold mining concessions (*Brisas* and *Unicorno*) granted by Venezuela. In 2009, the Government stated that the *Brisas* Concession had expired after the Concession had been extended in accordance with the underlying agreement; in 2010, the Government terminated the *Unicorno* Concession, citing delays in construction by Claimant, late exploitation and lack of hiring of interns, all in violation of contractual obligations. In 2008, Venezuela had annulled a construction permit in view of alleged environmental concerns and the protection of indigenous peoples.

In the dispute before ICSID, Venezuela argued that all of its measures were taken for commercial (and not for political) reasons, contrary to Claimant's pleadings. Thus, the Tribunal had to examine the established principle that an expropriation will only be assumed when the host State has exercised its power as a sovereign (*puissance publique*) and has not decided the matter based on its regulatory power to enforce contracts.

In practice, drawing this distinction may involve difficult decisions on the evidence presented. In the present case, the political climate of excluding foreign investors based on a narrow emphasis on the sovereignty of Venezuela had to be taken into account. Nonetheless, while recognizing that the issue was 'not straightforward', the Tribunal found that Claimants had not established that Venezuela had acted for political reasons, pointing to the breach by the Claimant of its obligation under the concession. The Tribunal cited *Malicorp v Egypt*, and formulated that the termination 'could not be said to be merely "pretextual", a plausible ground for termination existed'.[18]

[16] ibid para 362.
[17] *Gold Reserve* (n 2).
[18] *Malicorp Limited v Arab Republic of Egypt*, ICSID Case No ARB/08/18, Award (7 February 2011) para 142.

This position seems, at least at first sight, to be at variance with the emphasis on the political motives on the part of Venezuela in the earlier reasoning in the Award on the FET standard. Possibly, the Tribunal seems to be saying that the objective existence of a commercial ground for an action suffices to exclude an exercise of sovereign power, even if the evidence suggests that the decision was in fact driven by political considerations. However, this proposition may not be persuasive. It is plausible to argue that the existence of the exercise of sovereign power is a factual matter to be based on the evidence before the Tribunal, and not an issue of legal construction of the right *in abstracto* to act on a commercial basis.

As in the *ConocoPhillips* case, the date of valuation was contentious, albeit under peculiar circumstances. The issue of the consequences of an illegal act arose because the Tribunal concluded that Venezuela had not accorded fair and equitable treatment.

The Tribunal found 'particularly egregious breaches of FET',[19] including a lack of transparency, of consistency and good faith, as well as a disregard of legitimate expectations and of the right to be heard,[20] with reference to *Metalclad v Mexico*.[21]

The Tribunal in the end relied on the date of the taking and not on the date of the Award, the illegality of the measures notwithstanding.[22] While this approach may at first sight be considered as unorthodox or inappropriate, the Tribunal was able to point to a good reason for its position: both parties agreed on the date of the taking (as opposed to the date of the Award) as the date of valuation. Venezuela did so as it argued that there was no breach of the BIT; Claimants may have considered that the date of the taking was advantageous to the calculation of the value of the investment and of the interest.

In essence, the Tribunal recognized that a different approach was possible, but accepted that the common position of the parties modified the rules of customary law on the determination of damages. Under these circumstances, the ruling of the Tribunal was not objectionable. While the reasoning of the Award on this point could have been more straightforward, the Tribunal was right to point to its margin of discretion in determining the amount granted under Article XII(9) of the BIT.[23]

[19] *Gold Reserve* (n 2) para 615.
[20] ibid paras 591–606.
[21] *Metalclad Corporation v United Mexican States*, ICSID Case No ARB(AF)/97/1, Award (30 August 2000).
[22] *Gold Reserve* (n 2) paras 672ff; tribunals have often relied on the date of the Award, see eg *ADC Affiliate Limited and ADC & ADMC Management Limited v Republic of Hungary*, ICSID Case No ARB/03/16, Award (2 October 2006) paras 481, 483. In these cases, the date of the award was typically more favourable to the claimant than the date of the taking. The situation will be different in times of sinking prices, and the application of the *Chorzów Factory* standard will then require that the date of the taking will be applied.
[23] ibid para 675.